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No. ——

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

SUMITOMO TRUST & BANKING CO. (U.S.A.),
Petitioner,

v.

EDEN HANNON & COMPANY,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. In a diversity case, may a court of appeals, without finding that the trial court abused its discretion, itself rebalance the equities and order an equitable remedy that was considered but rejected by the district court?

2. Does the requirement of Fed. R. Civ. P. 52(a) that findings of fact by a district court not be set aside unless they are "clearly erroneous" apply also to equity cases arising under the diversity jurisdiction of a federal court?

3. May a court of appeals in a diversity case order an equitable remedy, when there is no state law precedent on point and where the district court sitting in that state has concluded not to issue that remedy, without certifying the question to the state court?

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PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.[1]

OPINIONS BELOW

The opinion of the court of appeals is reported at 914 F.2d 556 and is reprinted in the Appendix to this Petition (App. 1a). The transcribed oral opinions of the district court during and after trial, not reported, are also reprinted in the Appendix (App. 20a).

JURISDICTION

The judgment of the court of appeals was entered on September 19, 1990 (App. 1a). A timely petition for rehearing was denied on November 6, 1990 (App. 35a).

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[1] Information required by Rule 29.1: Petitioner is Sumitomo Trust & Banking Co. (U.S.A.). Its parent is The Sumitomo Trust & Banking Co., Ltd.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

In this diversity case, the district court ruled that petitioner had committed a breach of a non-compete clause in a contract by participating in bidding on a financial transaction. The district court found, however, (1) that respondent, the other party to the contract, suffered no legal injury because its bid on the transaction would not have been successful even if there had been no breach, and (2) that an independent third party had actually formulated the bid the court attributed to petitioner. The district court accordingly denied respondent monetary relief but enjoined petitioner from further breaches. The court of appeals "questioned" certain of the district court's findings but did not set them aside, rebalanced the equities, and ordered the district court to impose a constructive trust on petitioner's profits because of its breach. Because this remedy was not requested by respondent and moreover finds no support in any state statute, judicial decision, or secondary authority on equitable remedies, petitioner sought rehearing and specifically urged the court of appeals to certify the remedy question to the state supreme court. The petition for rehearing was denied.

Petitioner seeks review in this Court because the court of appeals' decision is not merely an utterly unprecedented and erroneous federal intrusion into the state law of equitable remedies but is also (a) an unwarranted failure to give appropriate deference to a district court's choice of equitable remedies, (b) a collateral attack on the duty of an appellate court to accept district court findings that are not "clearly erroneous," Fed. R. Civ. P. 52(a), and (c) an unexplained and unexplainable failure to certify the underlying questions to the relevant state court despite there being no state law precedent and despite the district court, sitting in that state, having reached the opposite conclusion on the point.

We now set forth the essential details.

The Xerox Corporation operates an asset financing scheme called the PAS Program. Each quarter, Xerox calls for bids for the purchase of a large quantity of copiers that are out on lease. After selecting the winning bidder, Xerox collects the rents and pays them to the buyer each month for up to five years. Xerox has the right to repurchase the copiers at prices determined in accordance with the sales contract. Prospective buyers, before bidding on the transaction, are given Xerox's forecasts of how many copier leases would be cancelled, how many lessees would default, how many lessees would buy their copiers, etc. The bids reflect each bidder's assessment of the risks associated with those forecasts.

Respondent is the leading bidder in the PAS Program. It had successfully won bids for about $350 million worth of copiers over a 2½ year period before this case began. It never risked its own funds in a transaction. Instead, it secured from investors non-recourse financing, *i.e.*, the investors looked only to the copiers and the revenue expected from them for recovery of their investment. Thus, the investors took all the risks. Respondent borrowed 1.5 percent more than the amount it bid to Xerox, and the difference was its fee.

Petitioner is a New York bank and the subsidiary of a Japanese bank. In March 1988, it was asked by another bank to consider investing in the PAS Program. After carefully studying the Program and its risks, it committed $30 million of non-recourse financing in support of a bid to be submitted in June 1988 by another company, called DPF. A DPF officer named Gerald Sherman, who had been involved with the PAS Program since its beginning in 1985, educated petitioner on the technical aspects of the Program.

Respondent, which is a competitor of DPF's in this bidding activity, was the winning bidder in June 1988. Petitioner then began discussions with respondent about

financing its participation in the transaction. Respondent gave petitioner some results of its analysis of the transaction. Respondent considered some of this information confidential and proprietary to it, so at its request petitioner signed an agreement that it would not use the information for any other purpose. The agreement also contained a non-compete clause under which petitioner agreed that it would not "independently pursue" PAS Program transactions for five years. The parties then discussed a financing arrangement but were unable to reach any agreement.

Thereafter, Mr. Sherman left DPF to start his own financing business, based on his wide knowledge of the PAS Program and other complex financing arrangements. He approached petitioner about participating with him on a PAS Program bid. After considerable discussion, Mr. Sherman received petitioner's backing and submitted a bid to Xerox for the December 1988 transaction. It was successful. But instead of title to the copiers passing from Xerox to Mr. Sherman's company, with petitioner having a security interest in them, title passed directly to petitioner. Mr. Sherman received a fee.

Respondent sued petitioner under Virginia law and claimed (a) misappropriation of respondent's trade secrets and (b) breach of the "independently pursue" covenant. After trial, the district court found for petitioner on the first claim. On the second claim, the court, although explicitly finding that Mr. Sherman had prepared the winning bid to Xerox, ruled that petitioner, by taking title to the copiers, had committed a breach of the non-compete clause. However, it found that respondent's bid on the December 1988 transaction was no better than *third*, that accordingly respondent could not have won even if there had been no breach, and that respondent could not collect damages. The court enjoined further breaches. The district court was expressly asked to award respondent a constructive trust on petitioner's profits, and it expressly refused to do so, holding that this remedy

would be appropriate only if respondent had proved misappropriation of trade secrets.

On appeal, respondent argued that petitioner's obligation under the "independently pursue" clause was *fiduciary* in character and that *for that reason* the constructive trust remedy should have been imposed. Neither side briefed the question whether the constructive trust remedy was available in the absence of a fiduciary obligation (or a misappropriation of trade secrets).

The court of appeals did not rule on the fiduciary argument. Nor did it overturn any of the district court's findings, including its findings (i) that respondent's bid would not have won even if petitioner had committed no breach of the "independently pursue" clause in the agreement, (ii) that there had been no misappropriation of trade secrets, and (iii) that Mr. Sherman had independently prepared the winning bid. Instead, it "questioned" these findings. Then, after confessing that there was no Virginia case on point, the court

—discussed cases involving breaches of employee covenants not to compete (where constructive trusts are *never* imposed) and misappropriation of trade secrets (on which issue petitioner had prevailed),

—cited a Virginia dictum that there is "no limit to [the] variety and application" of equitable remedies, and

—proceeded to impose the constructive trust remedy on petitioner.

Petitioner filed a timely petition for rehearing and made the following arguments:

1. Under Virginia law, a constructive trust may be imposed for breach of fiduciary duty, actual fraud or unconscionable conduct amounting to constructive fraud.[2]

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[2] Greenspan v. Osheroff, 232 Va. 388, 392, 351 S.E.2d 28, 36-37 (1986); Leonard v. Counts 221 Va. 582, 588-90, 272 S.E.2d 190, 195 (1980); Porter v. Shaffer, 147 Va. 921, 928-29, 133 S.E. 614, 616

Petitioner, however, has committed no fraud, either actual or constructive, or breach of any fiduciary duty and has not engaged in any other conduct that supports an equitable duty to convey its profits on the Xerox transaction. Indeed, there was no ruling by the trial court or the court of appeals that petitioner was under an equitable duty to convey anything to anyone. All that has been adjudicated is that petitioner has committed a breach of contract.[3] Under Virginia law, a court is not free to decide that some breaches of contract are "more wrong" than others and to impose an additional remedy.[4]

2. In addition, "in order to obtain a constructive trust, the plaintiff must identify specific property as the res of the trust to which he is entitled." Bogert on Trusts and Trustees, § 471, at p. 9 (rev. 2d ed. 1971). Petitioner holds no such res.[5]

(1926). This formulation is in line with the general proposition that a constructive trust is based on an equitable duty compelling the transfer of property. *See generally* Restatement of Restitution § 160 (1937); Bogert on Trusts and Trustees § 471 (rev. 2d ed. 1971); 19 Michie's Jurisprudence, *Trusts and Trustees* § 48 (1985); 4 Pomeroy, Equity Jurisprudence § 1044 (5th ed. 1941); V Scott on Trusts § 462 (3d ed. 1967).

[3] Under Virginia law the constructive trust remedy, being a remedy in equity, is not available for breach of contract, an action at law. *See, e.g.*, H-B Ltd. Partnership v. Wimmer, 220 Va. 176, 180, 257 S.E.2d 770, 773 (1979); 7 Michie's Jurisprudence, *Equity* § 9, at pp. 221-222 (1985); *id.* § 11, at p. 227. This conforms to all the other authorities. *See, e.g.*, 76 Am. Jur. 2d, *Trusts* § 224 (1975); Bogert, *supra*, § 471, at pp. 9-10; *id.* § 479, at p. 180; 2 Corbin on Contracts § 401, at p. 373 (1950); *cf.* McKey v. Paradise, 299 U.S. 119, 122-23 (1936).

[4] *See* Kamlar Corp. v. Haley, 224 Va. 699, 707-08, 299 S.E.2d 514, 518 (1983) (no punitive damages for breach of contract, even where "malicious" motives underlie the breach, in the absence of "an independent, wilful tort"). Indeed, "the infliction of punitive damages would be inconsistent with fundamental principles of equity jurisprudence," 7 Michie's Jurisprudence, *Equity, supra*, § 9, at p. 222.

[5] It is settled that money does not qualify as "property" for this purpose. The procedure for obtaining a money judgment is an

3. A constructive trust may be imposed only in favor of one who has a superior right to the property in question.

> In the interest of justice, equity treats as done what ought to be done, and a chancellor is empowered to fasten a trust upon the conscience of a party who has acquired property *to which another has a superior right.*[6]

Here respondent has no "superior right" to the profits on the Xerox transaction, and neither the district court nor the court of apeals so concluded.[7]

4. A remedy in the nature of a constructive trust may be appropriate where a defendant has misappropriated the plaintiff's trade secrets and has earned profits on them that exceed what the plaintiff itself could have earned. *E.g.*, 76 Am. Jur.2d, *Trusts* § 229 (1975). It would be bizarre to impose that remedy here, where

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action "at law" for damages, not a "bill in equity" for imposition of a constructive trust. *See* V Scott on Trusts, *supra*, § 462.3, at p. 3419; 19 Michie's Jurisprudence, *Trusts and Trustees*, *supra*, § 48, at p. 107. Yet respondent has been found not entitled to damages for breach of contract because it suffered no legal injury.

[6] Campbell v. Corpening, 230 Va. 45, 49, 334 S.E.2d 589, 592 (1985) (emphasis added). *See also* Bogert, *supra*, § 471, at p. 3; *id.* at p. 8. Restatement of Restitution § 160 comment *a*, at p. 641; 19 Michie's Jurisprudence, *Trusts and Trustees*, *supra*, § 48, at pp. 105-06.

[7] The point of a constructive trust is generally to restore the status quo. Restatement of Restitution, § 160 comment *d*, at 643; V Scott on Trusts, *supra*, § 462.2 at 3417. It is not designed to give a plaintiff a windfall, just as the law of contract damages is aimed at giving the plaintiff only the benefit of his bargain and no more. 5 Corbin on Contracts § 992, at p. 5 (1964); H. Hunter, Modern Law of Contracts: Breach and Remedies ¶ 7.02 (1986); 25 C.J.S. *Damages* § 3 (1966); *cf.* Sperry Rand Corp. v. A-T-O, Inc., 447 F.2d 1387, 1392 (4th Cir. 1971) (plaintiff in misappropriation case may not recover both its loss and defendant's profit), *cert. denied*, 405 U.S. 1017 (1972). But a windfall is exactly what the court of appeals has given the plaintiff in this case.

after a trial petitioner has been found innocent of misappropriating trade secrets.[8]

Petitioner expressly asked the court of appeals to certify the constructive trust question to the Virginia Supreme Court. The petition was denied.

REASONS FOR GRANTING THE WRIT

At first reading this case may appear to be nothing more than a simple breach of contract action in federal court applying state law in which the court of appeals committed a clear error in its decision on the state law question. A more careful examination of the facts indicates that the case raises important and unanswered questions about the standards a federal appeals court should apply in reviewing a district court's decision to issue one equitable remedy and to deny another.

Equity is an area of the law with ancient origins which remains a vital part of federal judicial power. Over the last 200 years the decisions of this court have created a considerable body of case law. On the issues posed by this case, however, a clarification of the law is badly needed. The case before the Court involves a simple set of facts which provide a setting in which the federal law questions emerge with clarity.

First, the court of appeals failed to review the district court's choice of equitable remedies under the proper standard—whether the district court abused its discretion—and indeed never identified the standard of review it was employing. This usurpation of the role of a district court is clear error on which the Fourth Circuit and all other courts of appeals are in need of in-

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[8] Nor is this case like those involving highly unusual circumstances where courts sometimes say that this kind of remedy is appropriate "whenever it becomes necessary to prevent a failure of justice," Sundin v. Klein, 221 Va. 232, 240, 269 S.E.2d 787, 792 (1980) (husband who murdered his wife ruled constructive trustee for property held with wife by entirety), *cert. denied sub nom.* Cross v. Sundin, 452 U.S. 911 (1982).

struction because of conflicting and misunderstood notions about the appropriate standard.

Second, the Fourth Circuit, having been admonished in *Anderson* v. *Bessemer City*, 470 U.S. 564 (1985), for its misapplication of Fed. R. Civ. P. 52(a)—which requires that a district court's findings of fact be respected by an appellate court unless they are "clearly erroneous"—has apparently found a new way to avoid the Rule. The court did *not* make a "clearly erroneous" determination, but it cited evidence contrary to certain findings—evidence that is *always* present in a trial record—and thereupon did its own balancing of the equities to arrive at a result different from the district court's. This Court has reminded courts of appeals about the "clearly erroneous" standard on several occasions. But it is necessary to make clear (*i*) that the Court's decisions apply equally to federal courts sitting in diversity and exercising equitable powers and (*ii*) that the Rule may not be circumvented by simply rebalancing the equities on appeal after a one-sided review of the record.

Third, the Court has never provided discernible standards for the exercise by a federal diversity court of its authority to certify questions of state law to state courts. The court of appeals in this case seems to have developed its own ideas about what Virginia law provides on the issue of equitable remedies for breach of contract, ignoring the very different conclusion reached by the district court, sitting in Virginia.[9] Inasmuch as this case provides an egregious example of a federal court's failure to respect the primacy of state law in a diversity case, it provides a good vehicle for some much-needed clarification by this Court of when the discretion to certify a case should be exercised.

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[9] If the Court decides in Salve Regina College v. Russell, No. 89-1629, O.T. 1990 (argued November 27, 1990), that a district court's decision on state law is entitled to deference, the decision below could be vacated with a remand to reconsider in light of the Court's decision, or the Court may need to address further the question of deference in the context of this case—because it involves equitable remedies rather than substantive contract law.

I. THIS COURT SHOULD PRESCRIBE THE STANDARDS THAT GOVERN APPELLATE REVIEW OF EQUITABLE DECREES ISSUED BY DISTRICT COURTS IN DIVERSITY CASES.

The district court judge, after reviewing all the evidence, including the oral testimony of eleven witnesses, made his findings of fact. This included findings

(i) that respondent had no chance of winning the bid on the December 1988 Xerox transaction,

(ii) that petitioner did not use respondent's confidential or proprietary information, and

(iii) that Mr. Sherman—not petitioner—had prepared the winning bid.

The district judge carefully balanced the competing interests and awarded what he considered to be the proper equitable remedy—an injunction to prevent further breaches of the non-compete clause in the contract. The judge specifically refused to grant the request of respondent that he impose a constructive trust on defendant's profits, ruling that such a remedy would be appropriate only if there had been a misappropriation of trade secrets or a breach of fiduciary duty.

On appeal, respondent challenged two of the district court's actions: It contended that the finding that respondent could not have won the bid was clearly erroneous, and it claimed that petitioner's breach of contract was also a breach of a fiduciary duty and that, *for that reason*, a constructive trust should have been awarded.

The Fourth Circuit did not rule in respondent's favor on either of these two points. Instead, it followed a course of action that was entirely its own.

With regard to the district judge's findings:

—it contradicted the finding regarding respondent's chance of winning, commenting that "given

[respondent's] success in bidding for past portfolios, its chances of succeeding [in the competitive bidding process] may have been quite good . . . ." (914 F.2d at 564; App. 18a) The trial judge had been asked to make this very finding and had refused to do so. (App. 24a-25a) The court of appeals never explained why it disagreed with the trial judge on this point.

—it expressed "doubts about the correctness of" the finding that petitioner did not use respondent's confidential business information, a finding the court characterized as a "close call". (914 F.2d at 560; App. 8a) The trial judge saw and heard all of the witnesses and gave not the slightest indication that his finding on this point was a "close call." [10]

—it speculated that Mr. Sherman did not prepare the bid. (914 F.2d at 559, 560; App. 8a) It gave no reason for this speculation, which is directly contrary to the trial judge's finding on this question.

Then the court of appeals rebalanced the equities and ordered that a constructive trust remedy be imposed. The court never identified the appropriate standard of review applicable to the award of an equitable remedy by a federal court sitting in diversity, and the court never ruled that any of the district court's findings of fact were clearly erroneous. Instead, it simply observed that "this remedy does not depend on proof of actual damage to [respondent]; instead, it focuses on the wrongful conduct of the violator." (914 F.2d at 560; App. 9a) [11]

This free-wheeling usurpation of the responsibilities and prerogatives of the trial judge in this case in equity poses two separate issues that the Court should address.

First, the court of appeals did not give proper deference to the trial court's findings of fact. The Court should hold unequivocally that the "clearly erroneous" limitation on appellate review of findings of fact applies

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[10] In fact the evidence in petitioner's favor was very substantial.

[11] This is plainly incorrect as a matter of Virginia law. *See* p. 6 & n.4, *supra*.

fully to diversity cases in equity and that this limitation cannot be circumvented by rebalancing the equities on appeal based on a selective review of the trial evidence or on speculation by the court of appeals.

Second, the Court should declare that, inasmuch as a district court has broad discretion in awarding an equitable remedy, appellate review of that discretion is limited to instances where the trial court has abused its discretion, and indeed a court of appeals does not have the power to order a brand new equitable remedy.

If the Court accepts our position on either of these points, the result would be to reverse the decision of the court of appeals.

We take up these points in reverse order.

A. A District Court's Choice of Equitable Remedy Should Not Be Set Aside Unless It Was an Abuse of Discretion.

The opinions of this Court have stressed, time and time again, that a district court's decision to grant an equitable remedy is a matter of discretion.

In *Eccles* v. *Peoples Bank of Lakewood Village*, 333 U.S. 426, 431 (1948), a suit seeking equitable relief against the Board of Governors of the Federal Reserve System under the Declaratory Judgment Act, Justice Frankfurter noted that a declaratory judgment "like other forms of equitable relief, should be granted only as a matter of judicial discretion . . . ." *See Brotherhood of Locomotive Engineers* v. *Missouri-Kansas-Texas R.R.*, 363 U.S. 528, 535 (1960) (preliminary injunction in Railway Labor Act case); *Lemon* v. *Kurtzman*, 411 U.S. 192, 201 (1973) (interim injunction in case involving constitutional claims) (per Burger, C.J., with three Justices concurring and one Justice concurring in the judgment); *Virginian Ry. Co.* v. *System Federation No. 40*, 300 U.S. 515 (1937) (injunction in case questioning the constitutionality of provisions of Railway Labor Act) ("the extent to which equity will go to give relief where there is

no adequate remedy at law is not a matter of fixed rule. It rests rather in the sound discretion of the court"); *Hecht Co.* v. *Bowles*, 321 U.S. 321, 329 (1944) (injunction in Emergency Price Control Act case); *DiGiovanni* v. *Camden Fire Ins. Ass'n*, 296 U.S. 64, 73 (1935) (whether district court may accept jurisdiction over suit to cancel two fire insurance policies, neither of which meets the statutory jurisdictional amount).

It should follow from these cases that, because a trial court's decision to grant or withhold an equitable remedy is an exercise of discretion, the decision is reviewable only to the extent that discretion has been improvidently exercised. That, indeed, has been the ruling in several cases, such as *Weinberger* v. *Romero-Barcelo*, 456 U.S. 305, 320 (1982), and *Lemon* v. *Kurtzman*, *supra*.

In *Romero-Barcelo* this Court ruled that the Federal Water Pollution Control Act did not foreclose completely a district court's discretion to choose a remedy to secure compliance with the Act. *Id.* at 311-20. After noting that the decision to deny as well as to grant equitable relief was within the discretion of the trial court, Justice White went on to point out that "the proper standard of appellate review is whether the District Court abused its discretion" in denying equitable relief. *Id.* at 320.

In *Lemon* this Court neatly summarized the connection between the trial judge's discretion and the scope of appellate review:

> In shaping equity decrees, the trial court is vested with broad discretionary power; appellate review is corresponding narrow.

411 U.S. at 200. *See Continental Illinois Nat. Bank & Trust Co.* v. *Chicago, R.I. & P.R. Co.*, 294 U.S. 648, 677 (1934).

The decisions of this Court emphasizing the narrow scope of appellate review are consistent with the structure of the judicial system created by Congress. The Court has recognized that the balancing of equities required for the award of equitable relief is best left to the

trial judge who has heard all the evidence. *International Salt Co.* v. *United States*, 332 U.S. 392, 400-401 (1947) (civil antitrust decree) ("the framing of decrees should take place in the District rather than in the Appellate Courts. They are invested with large discretion to model their judgment to fit the exigencies of the particular case"); *Hecht Co.* v. *Bowles*, 321 U.S. at 329 ("[t]he essence of equity jurisdiction has been the power of the Chancellor to do equity and to mold each decree to the necessities of the particular case"). *Cf. Inwood Laboratories* v. *Ives Laboratories*, 456 U.S. 844, 856 (1982) ("[d]etermining the weight and credibility of the evidence in the special province of the trier of fact").[12]

Despite the cases of this Court emphasizing the discretionary nature of equitable remedies and the appropriate standard of review for exercises of discretion—all of them involving federal statutes, the Constitution, or federal jurisdiction—there appears to be some confusion among the courts of appeals as to the standard of review that governs the award of an equitable remedy in diversity cases.

Some circuits have reviewed the district court's decision on equitable relief under a de novo standard. An example is *Smith* v. *Dravo Corp.*, 208 F.2d 388, 391-92 (7th Cir. 1953):

> * * * in equity, where the record is complete or the evidence uncontradicted or entirely documentary, the appellate court is bound to decide the case, so far as it is in condition to be decided, and direct such a decree as under all circumstances may be proper [citing pre-Federal Rules cases]. In Shore v. United States, 7 Cir., 282 F. 857 this court said at 860: 'There is no question but that this court, on an appeal from a decree in an equity suit, may consider the evidence, and make findings of fact which are determinative of the controversy.' * * *

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[12] In addition, the facts of this case pose a separate but related issue—whether a federal court of appeals even has the power to

Likewise, just recently the court of appeals in *In re Seneca Oil Co.*, 906 F.2d 1445, 1450 (10th Cir. 1990), said:

> Because [the award of a constructive trust] is an issue of law, we apply a de novo standard of review.

Other circuits, concluding that the fashioning of an equitable remedy is a fact-based determination, have applied a clearly erroneous standard. *Beatley Lanches, Inc.* v. *Borgerson*, 732 F.2d 1395, 1396 (9th Cir. 1984) (reformation of contract) (rejecting appellant's argument for de novo review in favor of the "settled law of this circuit requiring our review to be under the clearly erroneous standard") (*citing Dierks Lumber & Coal Company* v. *Barnett*, 221 F.2d 695, 697 (8th Cir. 1955) (action to quiet title)).

Still other circuits have concluded the abuse of discretion standard applies to a district court's choice of equitable remedy. *United States* v. *Tabor Court Realty Corp.*, 803 F.2d 1288, 1306 (3rd Cir. 1986) (equitable lien); *Downriver Community Fed. Credit Union* v. *Penn*

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order an equitable remedy that has been considered but rejected by the district court.

The United States Courts of Appeals, being the creation of Congress, derive all of their power from federal statutes. *See* U.S. Const. art. I, § 8, cl. 9; art. III, § 1. Section 2106 of title 28 U.S.C., is the basic statute empowering the courts of appeals. It provides that an appellate court may "affirm, modify, vacate, set aside or reverse any judgment, decree or order" of a lower court. *Id.* In Hunt v. Seeley, 115 F.2d 205, 207 (5th Cir. 1940), the court of appeals ruled that it had the power to modify a decree in equity and then affirm it. The court may also remand the case for the entry of any judgment "as may be just under the circumstances." *Id.* The statute does not say, nor has this Court interpreted it to mean, that a court of appeals may order a new remedy that the district court did not order after hearing all the evidence. The award of a constructive trust cannot be viewed as a "modification" of an injunction without the risk of serious terminological inexactitude.

Square Bank, 879 F.2d 754, 758 (10th Cir. 1989) (constructive trust).

The court of appeals in this case did not explain what standard of review it was applying to the decision of the district court, but it certainly gives no indication that it was following an abuse-of-discretion standard. Nor is its reasoning consistent with such a standard. The court never identified any error of law it thought the district court had made, and it never set aside any of the district court's findings as "clearly erroneous".[13] What is abundantly clear is that the court did not give *any* deference to the trial court's choice of an injunction as the sole remedy that is appropriate on the facts of this case. That is in square conflict with the holdings cited immediately above, which alone is enough to warrant a grant of certiorari—and reversal.

B. The "Clearly Erroneous" Standard Applies to Review of Findings of Fact In Diversity Cases in Equity As Well As All Other Cases.

The deferential standard applied to a trial court's decision to grant or withhold an equitable remedy would be rendered a mere nullity if a court of appeals were

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[13] Conceivably the court of appeals, although purporting to apply Virginia principles governing equitable remedies, was actually relying on the "equitable remedial rights doctrine." This doctrine advances the argument that, notwithstanding *Erie*, a federal court sitting in a diversity case may order an equitable remedy even if that remedy is not recognized by the law of the relevant state. Perfect Fit Industries, Inc. v. Acme Quilting Co., 646 F.2d 800, 806 (2d Cir. 1981); Atkins v. Schmutz Manufacturing Company, 401 F.2d 731, 742 (4th Cir. 1968) (Craven, J., dissenting) ("[t]here is ample authority that the equitable remedies doctrine survived *Erie*"). *See* 19 Wright, Miller & Cooper, Federal Practice & Procedure § 4513 (1982); Note, 67 Harv. L. Rev. 836 (1954).

The Court needs to review and clarify that point, which was addressed in a seemingly contradictory fashion in Justice Frankfurter's opinion in Guaranty Trust Co. v. York, 326 U.S. 99, 106 (1945), and has not been addressed by the Court since then.

free to make findings of fact on appeal. It is not at all clear that the court of appeals in this case believed itself bound by the "clearly erroneous" standards of Fed. R. Civ. P. 52(a) when it reviewed the factual findings of the district court. The Fourth Circuit engaged in a rebalancing of the equities: It plucked pieces of evidence out of the transcript, assigned different weight to the evidence, and on the basis of its anecdotal review of the record ordered a new remedy.

One would have thought it clear from decisions of this Court dating back to *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 395 (1948), that Rule 52(a) applies to *all* cases in the federal courts. This Court has warned that "[i]n applying the clearly erroneous standard to the findings of a district court sitting without a jury, appellate courts must *constantly have in mind* that their function is not to decide factual issues *de novo*." *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100, 123 (1969) (emphasis added). In *Pullman-Standard* v. *Swint*, 456 U.S. 273 (1982), a case arising under Title VII of the Civil Rights Act of 1964, Justice White stated quite clearly that Rule 52(a) "does not make exceptions or purport to exclude certain categories of factual findings from the obligation of a court of appeals to accept a district court's findings of fact unless clearly erroneous." *Id.* at 287. In a 1985 Title VII case the Court provided an even blunter synopsis: "Review of factual findings under the clearly-erroneous standard—with its deference to the trier of fact—is the rule, not the exception." *Anderson* v. *Bessemer City*, 470 U.S. 564, 575 (1985) (reversing Fourth Circuit for misapplying Rule 52(a)). And in *Bose Corp.* v. *Consumers Union*, 466 U.S. 485, 498 (1984), a diversity action at law, the Court said simply: "The Rule means what it says."

Despite these unambiguous repetitions of what the rule means, the courts of appeals may have a different view at least in equity cases under diversity jurisdiction. Thus, a recognized encyclopedia printed within the past decade flatly states that

> "An appellate court has greater latitude in reviewing findings and judgments in equity cases. The appellate court can make findings of fact, if the record so warrants, and may also enter findings contrary to a jury verdict, since the findings of a jury in an equity matter are not conclusive on an appellate court. . . ."

32 Am. Jur. 2d, *Federal Practice & Procedure* § 369 (1982) (citations omitted); *see also* 2 Federal Procedure § 3:655 (lawyers ed. 1981) (citations omitted).

None of this Court's recent decisions regarding the scope of review of findings involved a federal court exercising equitable powers in a diversity case. A review of the history of equitable actions in federal courts may explain the persistence of erroneous beliefs that have survived both the adoption of the Federal Rules and the clear and forceful decisions of this Court.

In 1802 Congress reestablished the previous practice of taking testimony by deposition in equity cases. Act of April 29, 1802, ch. 31, § 25, 2 Stat. 166. A statute passed a year later restored review by "appeal" in equity cases. Act of March 3, 1803, ch. 40 § 2, 2 Stat. 244. This brought the entire case up to the appellate court for review. Thus, an appellate court in equity regained the power it had previously had (*see Wiscart v. D'Auchy*, 3 U.S. (3 Dall.) 321, 327 (1796)) to review facts as well as law. To facilitate review of the facts the statute provided that the evidence introduced at trial and a transcript of the proceedings be sent to the Supreme Court. *Id.* The effect of these two statutes was to repeal the provisions of the Judiciary Act of 1789 and return the procedure in equity actions to what it had been in England and in the colonies. Note, *Rule 52(a); Appellate Review of Findings of Fact Based on Documentary or Undisputed Evidence*, 49 Va. L. Rev. 506, 509 n.18 (1963).

The case law on appellate review reflects the change in the statutes. In *Johnson* v. *Harmon*, 94 U.S. 317 (1876), Justice Brady ruled that an appeal in an equity case was

to be decided in the same way that a court of first instance would decide it; "upon the whole case, pleadings, evidence, and verdict . . . ." *Id.* at 372. In *Dodge* v. *Knowles*, 114 U.S. 430 (1884), Justice Gray said simply: "[t]his is an appeal in equity, the facts as well as the law are to be determined by this court." *Id.* at 434. *See also Ridings* v. *Johnson*, 128 U.S. 212, 218 (1888) ("on an appeal in an equity suit, the whole case is before us, and we are bound to decide it so far as it is in a condition to be decided."); *United States* v. *Rio Grande Dam & Irrigation Co.*, 184 U.S. 416, 423 (1902).

These broad statements claiming power to review facts de novo were modified, but only slightly, when the procedural rules were changed again in 1912. Equity Rule 46 scrapped the practice of using depositions and instead specified that testimony from witnesses be taken orally in open court. Equity R. 46, 226 U.S. 649, 661 (1912). In *Keller* v. *Potomac Elec. Power Co.*, 261 U.S. 428, 444 (1923), this Court said that "an appeal brings up the whole record and the appellate court is authorized to review the evidence and make such order or decree as the court of first instance ought to have made . . . ." The Court added that "proper weight to the findings on disputed issues of fact . . . should be accorded to a tribunal which heard the witnesses." The Court did not explain how a court should determine what weight was "proper," and it has never done so.

With the merger of law and equity in 1938 (Fed. R. Civ. P. 2), it would seem clear that the powers of a court of appeals with regard to a district court's findings of fact should be the same in all cases, federal question or diversity, at law or in equity. Indeed, the arguments for deference to the trial court's ability to hear witness testimony and determine the proper weight and credibility to be assigned to the evidence are no less compelling in an equity proceeding. For example, the Fourth Circuit's opinion in this case states specifically that the remedy ordered "does not depend on proof of actual damages to

[respondent]; instead, it focuses on the wrongful conduct of the violator." (914 F.2d at 560; App. 9a) The trial judge, after hearing the witnesses and viewing the evidence, however, is in a far better position to determine whether conduct is "wrongful" than a panel of appeals judges who review a cold record many months later. *See, e.g., Inwood Laboratories*, 456 U.S. at 856.

Yet the Fourth Circuit's decision in this case shows that the message has not gotten through. Although it does not discuss the source of its power to make new findings on appeal, other Circuits have done so—citing pre-Rules decisions of this Court. *E.g., Smith* v. *Dravo Corp.*, 208 F.2d 388, 391-92 (7th Cir. 1953) (citing *Ridings* and *Rio Grande Dam*); *Edwards* v. *Lain*, 112 F.2d 343, 347 (7th Cir. 1940) (citing *Keller*). It is entirely possible that other Circuits operate on the same belief, but *Smith* is the last discussion of the point that we have found.

There is also another, related problem. Where the appeals court does review a district court's findings of fact it must examine the entire record. This Court has ruled that a finding is

> 'clearly erroneous' when although there is evidence to support it, the reviewing court *on the entire evidence* is left with the definite and firm conviction that a mistake has been committed.

U.S. Gypsum Co., 333 U.S. at 395 (emphasis added); *Bose Corp.*, 466 U.S. at 465 (same).

In the case at bar no such comprehensive review of the evidence took place. One could not say of the Fourth Circuit's opinion before this Court that it "meticulously reviewed the entire record and reached the conclusion that the District Court was in error." *Anderson*, 470 U.S. at 581 (Powell, J., concurring). Rather, the Fourth Circuit's decision here bears an unflattering resemblance to the opinion in *Amadeo* v. *Zant*, where the appeals court "without examining the record or discussing its obliga-

tions under Rule 52(a) . . . simply expressed disagreement and substituted its own factual findings for those of the District Court." *Amadeo* v. *Zant*, 486 U.S. 214, 223 (1988).

The Court should make clear that its decisions interpreting Rule 52(a) apply to *all* cases in the district courts and that appellate courts may not make their own findings on appeal.

II. THE COURT OF APPEALS ABUSED ITS DISCRETION WHEN IT REFUSED TO CERTIFY THE NOVEL STATE LAW QUESTION TO THE VIRGINIA SUPREME COURT, ESPECIALLY WHEN THE TRIAL COURT, SITTING IN VIRGINIA, HAD REACHED A DIFFERENT CONCLUSION ABOUT WHAT VIRGINIA LAW PROVIDED.

This Court has ruled that where an unresolved state law question is presented in federal litigation a federal court may certify the question to the highest court of the state for an authoritative determination. *Clay* v. *Sun Ins. Office, Ltd.*, 363 U.S. 207 (1960). In *Clay*, a diversity action seeking recovery on an insurance policy, the Court reasoned that the interpretation of a Florida statute might avoid the need to decide a federal constitutional question. *Id.* at 211-12. Since the federal court could not make a "confident guess" as to how the Florida Supreme Court would resolve the two state law issues, Justice Frankfurter concluded that certification of the questions was an appropriate procedure. *Id.*[14]

In *Lehman Brothers* v. *Schein*, 416 U.S. 386, 390-91 (1974), the Court extended the scope of a federal court's

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[14] A federal court may certify questions to a state's highest court only if that state's law permits such certification. Planned Parenthood Ass'n v. Ashcroft, 462 U.S. 476, 493 n.21 (1983). The State of Virginia provides that a federal court may certify a question if if "Virginia law is determinative" in the case and "there is no controlling precedent on point" in the Virginia case law. Va. Sup. Ct. R. 5:42(a).

discretion to use state certification procedures. Even where no constitutional issue is at stake, the Court ruled that certification may be employed in simple diversity cases. Justice Douglas, writing for the Court, noted that certification "in the long run save[s] time, energy, and resources and helps build a cooperative federalism." *Id.*

While the Court's opinion in *Lehman Brothers* enthusiastically endorsed the certification procedure, it left many important questions unanswered. The Court noted that the decision on whether to certify a state law question was committed to the "sound discretion" of a federal court, but it did not provide adequate guidance on how that discretion is to be exercised. *See* 1 A.J. Moore, W. Taggert, A. Vestal & J. Wicker, *Moore's Federal Practice*, ¶ 0.203[5] at 2159 (2d ed. 1987).

The absence of clear standards for the exercise of discretion on this subject has prompted some courts of appeals to fashion their own rules. *See Florida ex rel. Shevin* v. *Exxon Corp.*, 526 F.2d 266, 274-75 (5th Cir.), *cert. denied sub nom. Standard Oil Co.* v. *Florida*, 429 U.S. 829 (1976); *Complaint of McLinn*, 744 F.2d 677, 681 (9th Cir. 1984) (noting that *Lehman Brothers* provides "no clear standards as to when certification should be used" and adopting Fifth Circuit standards).

It is time for this Court to adress the question of standards. The potential for certification arises frequently in federal courts. In the Fourth Circuit alone there were sixteen instances in the last two years in which state courts responded to certified questions from federal courts. If this case is any illustration there may well have been many more questions of state law which would have been certified if there were ascertainable standards for the exercise of discretion to be followed by lower federal courts.[15] This problem is particularly acute in cases

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[15] The Fourth Circuit has made use of the certification procedure but has not provided standards for when the discretion to certify should be exercised in diversity cases. *E.g.*, Commodities Reserve

where, as here, the federal court refuses to certify the question. If the court abuses its discretion by certifying the question, the state court may simply decline to answer the question. *See, e.g.*, Va. Sup. Ct. R. 5:42. However, if the court abuses its discretion by refusing to certify the question, there is no outside check on the court's discretion.

The Fifth Circuit has provided a useful list of factors to be considered by a federal court when determining whether to exercise its discretion in favor of certification. Of all the factors the Fifth Circuit evaluates,

> [t]he most important are the closeness of the question and the existence of sufficient sources of state law—statutes, judicial decisions, attorney general's opinions—to allow a principled rather than conjectural conclusion. But also to be considered is the degree to which considerations of comity are relevant in light of the particular issue and case to be decided. [The court] must also take into account practical limitations of the certification process: significant delay and possible inability to frame the issue so as to produce a helpful response on the part of the state court.

Florida ex rel. Shevin v. *Exxon Corp., supra*, 526 F.2d at 274-75 (footnotes omitted).

Were this Court to adopt the Fifth Circuit's guidelines and apply them to this case, the result would be a holding that the court of appeals abused its discretion when it refused to certify the state law question to the Virginia Supreme Court.

1. Viewing this case most favorably to respondent, the case presents a "close question" of state law for resolution in federal court. It requires a federal court, exercising jurisdiction by virtue of the diversity of citizenship of the parties, to apply the principles of equity developed in

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Corp. v. M/S Roumania, 806 F.2d 501 (4th Cir. 1986); Cross v. State Farm Mut. Auto. Ins. Co., 873 F.2d 75 (4th Cir. 1989); Boyd v. Bulala, 877 F.2d 1191 (4th Cir. 1989).

the Virginia courts. *See Erie R.R.* v. *Tompkins*, 304 U.S. 64 (1938.) As shown above, the decisions of the Virginia Supreme Court contain many cases applying broad equitable maxims of ancient origin. *E.g.*, *Sundin* v. *Klein*, 221 Va. 232, 240, 269 S.E.2d 787, 792 (1980) (an equitable remedy is appropriate "whenever it becomes necessary to prevent a failure of justice") (husband who murdered his wife ruled constructive trustee of property held with wife by entirety), *cert. denied sub nom. Cross* v. *Sundin*, 452 U.S. 911 (1982). The Virginia courts have also ordered equitable remedies to correct specific abuses triggered by carefully defined factual situations. *See Greenspan* v. *Osheroff*, 232 Va. 388, 351 S.E.2d (1986); *Leonard* v. *Counts*, 221 Va. 582, 272 S.E.2d 190 (1980). The close question here is whether the federal court should follow those cases dealing with constructive trusts that require specific factual findings—which are absent here—as a predicate for recovery.

2. The question whether a constructive trust may be imposed for a breach of contract under Virginia law is not one in which a federal court can make a "principled, rather than a conjectural" decision. 526 F.2d at 275. Although there are many cases from the Virginia courts dealing with constructive trusts as a remedy for a breach of fiduciary duty, actual fraud, or unconscionable conduct amounting to constructive fraud, there is nothing in Virginia law to suggest that a breach of contract, however egregious the court might believe it to be, can give rise to a constructive trust. Indeed, the Fourth Circuit confessed that it was unable to find "a Virginia case that addresses this type of situation", but the court claimed to have found "guidance" from Virginia cases "substantially similar to the case at bar" (App. 10a).[16]

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[16] The dangers inherent in a federal court's prediction of how a state court would respond in uncharted legal waters are illustrated by the procedural history of the *Lehman Brothers* case. In that case a majority of the Second Circuit concluded that, under Florida law, an individual unrelated to the corporation who traded

Not only was the Fourth Circuit's prediction of how a Virginia court would address this question a matter of pure conjecture, it was contrary to the conclusion of the district judge, sitting in Virginia, on the point. This Court already has before it *Salve Reginia College* v. *Russell*, No. 89-1629, O.T. 1990 (argued November 27, 1990). A key issue in that case is the deference a court of appeals should pay to a ruling on state contract law made by a district court, sitting in that state, in a diversity case. If the Court holds that such deference is the rule, it may wish to vacate and remand this case for further consideration in light of that ruling. Alternatively, inasmuch as this case involves equitable remedies, rather than substantive law, the fact that the district court and the court of appeals come out differently on a matter of state law should, we contend, be a further point in favor of certification.

3. Comity considerations indicate that the question of state law presented in this case should have been certified to the Virginia Supreme Court. The Fifth Circuit, when addressing comity issues, examines the likelihood of recurrence of the particular question before the court. 526 F.2d at 275 n.29. This case involves the remedies to be applied in a breach of contract action where the plaintiff has not suffered legal damages. It does not raise obscure questions of state law that are litigated once in a lifetime. The Fifth Circuit has ruled that it is precisely these ordinary, repetitive contract questions "which be-

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on inside information would be liable to the corporation in a shareholder derivative action. Schein v. Chasen, 478 F.2d 817, 823-24 (2d Cir. 1973). This Court vacated the judgment of the Second Circuit so that the court might consider certifying the question to the Florida Supreme Court. *Lehman Brothers*, 416 U.S. at 386. Pursuant to that direction the issue was certified to the Florida Supreme Court, which repudiated the decision of the majority of the Second Circuit and adopted the rationale of the dissent. The Second Circuit thereupon reversed its prior decision and reinstated the decision of the district court. *See* Schein v. Chasen, 519 F.2d 453, 454 (2d Cir. 1975).

cause of their recurring nature involving literally hundreds of contracts with many public factors affecting the welfare of local citizens, [which] call for unequivocal resolution by the final [state] court." *Barnes* v. *Atlantic & Pacific Life Ins. Co. of Amer.*, 514 F.2d 704, 706 (5th Cir. 1975).

The Fourth Circuit's decision in this case radically alters the state law of contract remedies. If a change in Virginia law of this magnitude is to be made judicially, at the very least the Virginia courts should be responsible for the change. This is the only result consistent with the spirit of "cooperative judicial federalism." *Lehman Brothers*, 416 U.S. at 392.

4. The delay involved in certifying the question in this case would not be significant. The state law issues were fully briefed by the parties in response to Sumitomo's petition for rehearing. In any event, the peculiar nature of this case—where the court of appeals *sua sponte* orders a remedy not requested by the plaintiff—means that some delay is inherent. If the Virginia Supreme Court on certification had ruled in favor of petitioner's position, however, the case would have come to an end, whereas now we are undergoing further proceedings in the district court to determine petitioner's profits pursuant to the order of the court of appeals.

5. Finally, the question to be presented to the Virginia Supreme Court does not involve complicated factual or legal issues that would make the framing of a certified question difficult or unworkable. In the case before this Court there are two parties, one contract, and one breach of contract. While the legal question is important and unresolved, it is an issue which, properly framed. would readily produce a useful response from the state court.

Where, as here, all of the factors guiding a federal court in the exercise of its discretion point to certification, and the federal court's decision on the state law question produces an extraordinary extension of state law, it is

an abuse of discretion for the court of appeals not to certify the issue to the highest court of state for an authoritative determination. This Court should so rule and thereby clarify for all federal courts the proper approach to this important certification procedure.

CONCLUSION

The Court should issue the writ and should reverse the decision of the court of appeals in this case.

Respectfully submitted,

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January 15, 1991

APPENDIX

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 89-2201

EDEN HANNON & COMPANY,
Plaintiff-Appellant,

versus

SUMITOMO TRUST & BANKING COMPANY,
Defendant-Appellee.

No. 89-2208

EDEN HANNON & COMPANY,
Plaintiff-Appellee,

versus

SUMITOMO TRUST & BANKING COMPANY,
Defendant-Appellant.

Appeals from the United States District Court
for the Eastern District of Virginia, at Alexandria
Claude M. Hilton, District Judge. (CA-89-312-A)

Argued: July 18, 1990 Decided: September 19, 1990

Before RUSSELL, WIDENER, and HALL, Circuit Judges.

Affirmed in part, reversed in part, and remanded by published opinion. Judge Russell wrote the opinion, in which Judge Widener and Judge Hall joined.

ARGUED: Ralph N. Albright, Jr., MORGAN, LEWIS & BOCKIUS, Washington, D.C., for Appellant. John Vanderstar, COVINGTON & BURLING, Washington, D.C., for Appellee. ON BRIEF: Peter Buscemi, Brian B. Darville, MORGAN, LEWIS & BOCKIUS, Washington, D.C., for Appellant. John C. Richowsky, COVINGTON & BURLING, Washington, D.C., for Appellee.

RUSSELL, Circuit Judge:

Eden Hannon & Co. ("EHC") is an investment company located in Alexandria, Virginia, and Sumitomo Trust & Banking Co. is a New York subsidiary of a Japanese bank. This appeal involves the competition between EHC and Sumitomo to purchase an investment portfolio from Xerox Corporation. In the past, EHC has produced extensive economic models for the purpose of valuing Xerox lease portfolios, bidding on these portfolios, and selling the income rights to the portfolios to institutional investors. In the late summer of 1988, Sumitomo indicated interest in purchasing a portfolio through EHC. To that end, Sumitomo signed a "Nondisclosure and Noncircumvention" agreement with EHC,

in order to protect the confidential information that EHC later shared with Sumitomo. In violation of that agreement, and after taking possession of EHC's confidential analyses, Sumitomo bid on the December 1988 Xerox portfolio, won the bid, and made a direct purchase of the portfolio. EHC had bid also on that portfolio, and its bid was ranked third by Xerox officials.

EHC subsequently filed this suit, stating four counts: misappropriation of trade secrets, breach of contract, breach of fiduciary duty, and breach of the duty of good faith and fair dealing. Sumitomo denied these allegations, and filed a counterclaim which primarily asserted that EHC's complaint was a sham suit and an attempt at monopolization in violation of the Sherman Act, 15 U.S.C. § 2. The four counts in the counterclaim (as amended) were monopolization, attempted monopolization, breach of duty of good faith and fair dealing, and interference with prospective business relations. Both parties' counts alleging a breach of covenant of good faith and fair dealing were eliminated prior to trial, and they are not raised in this appeal. At trial, at the close of plaintiff EHC's case, the district judge, satisfied that the case was not a sham, dismissed the remainder of Sumitomo's counterclaim. The district judge also struck EHC's claim for monetary damages at that point. He held that since EHC's bid was ranked third by Xerox, EHC had not proven monetary damage from Sumitomo's bidding with sufficient certainty, because it was most likely that the second place bidder would have won the portfolio in that instance. Since EHC's request for an injunction was the only claim for relief remaining, the district judge dismissed the jury, and the trial continued on EHC's complaint. After hearing all of the evidence, the judge found that Sumitomo's actions constituted a breach of contract, and found that a misappropriation of trade secrets had not been proven. It is unclear as to whether the judge found that a breach of fiduciary duty had taken place.

However, our decision does not depend on the resolution of that count.

As a remedy, the district judge enjoined Sumitomo from repeating its violation of the Noncircumvention and Nondisclosure Agreement. Both parties have appealed the rulings adverse to their positions, and we affirm in part, reverse in part, and remand.[1] Most importantly, we find that EHC is entitled to a constructive trust on Sumitomo's profits from the portfolio purchase as an equitable remedy for their breach of the agreement. We also find that the district judge was not clearly erroneous in dismissing Sumitomo's claim that this suit was a sham.

I.

The "portfolio" that Xerox sells is composed of the right to receive the stream of income from a group of copiers leased by Xerox, and to receive the residual value of the copiers when the leases expire or are terminated. This is known as the Xerox Partnership Asset Strategy ("PAS") Program. Four times a year, Xerox invites a limited number of investors to bid for a portfolio, which typically contains several hundred copiers leased by Xerox to various customers for terms usually ranging from one to three years. EHC has been a regular bidder and frequent winner in the past, winning ten quarterly bids in the first three-and-a-half years of the program. The bids submitted to Xerox are not just dollar figures; instead, a bid consists of several components, and each component addresses how an element of the projected revenue stream would be divided between Xerox and the successful bidder.

EHC does not bid with its own money in these sales. Instead, it arranges in advance for a bank or insurance company to provide the monetary investment, and in return that investor receives all of the revenue generated

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[1] On July 13, 1990, EHC made a motion to this court to add plaintiff's exhibits 11 and 12 to the appeals appendix. That motion is granted, and we have considered that information in this opinion.

by the leases. The investor takes a security interest in the equipment and leases purchased, and agrees to look only to that security in the event of a default. EHC makes a profit by charging the investor a certain percentage over the portfolio's purchase price, and thus after paying back the entire return on the portfolio to the investor, it generates its own margin in the mark-up. For example, EHC would often charge the investor 101.5% of the portfolio purchase price, pass on all of the income received, and achieve a margin of 1.5%. Hence, EHC does not make money by investing in these portfolios; it makes money by selling its expertise in valuing portfolios to institutional investors.

Given that EHC's value is in its knowledge, it must guard that knowledge jealously. On the other hand, it must also disclose a great amount of its confidential analysis regarding a proposed bid on a portfolio in order to convince an institution to bid from $25 million to more than $60 million on a single portfolio. To that end, EHC requires any interested investor to sign a "Nondisclosure and Noncircumvention Agreement" (an "Agreement") before it can receive any of EHC's confidential information. This Agreement requires that the investor not disclose the information it receives from EHC to other parties. Most importantly, it also requires that the potential investor "not independently pursue lease transactions" with Xerox's PAS Program "for a period equal to the term of the Purchase Agreement." Since the copiers are usually leased for one to three years, we presume that this term would prevent an investor from independently pursuing a portfolio for approximately three years.

Sumitomo was a potential investor interested in the PAS portfolio. Immediately after EHC won the June 1988 portfolio bid, a Sumitomo officer, Ragheed Shanti, based in the United States, telephoned EHC to express interest. In order to evaluate the PAS program, Shanti attempted to obtain EHC's economic data on their win-

ning June bid. EHC insisted that it could not disclose that information without an Agreement signed by a Sumitomo representative. Shanti tried to avoid signing an Agreement, and then attempted to water down the provision that would require Sumitomo not to "independently pursue" portfolio purchases. Shanti proposed to delete that provision, and substitute language that would require (1) that Sumitomo would notify EHC if it decided to pursue lease transactions on its own, and (2) that it could not use EHC's confidential information if it decided to bid. EHC refused this substitution, and Shanti eventually signed the original Agreement on the part of Sumitomo. During these negotiations over the language of the Agreement, Sumitomo admitted to EHC that it was also considering financing a portfolio bid by a competitor of EHC, DPF Leasing Services, Inc. ("DPF"). EHC indicated that the Agreement would not prevent Sumitomo from financing a competitor's bid. However, EHC did not want to create a new competitor that would use EHC's information to bid directly against it. Thus, the understanding between EHC and Sumitomo was that Sumitomo could finance a competitor's bid, but it could not directly bid (*i.e.*, "independently pursue") on a portfolio during the "term of the Purchase Agreement."

Once the Agreement was signed, EHC disclosed a great amount of confidential bidding information to Sumitomo: confidential information regarding the June bid, how the bid had been prepared, what EHC's bidding strategy had been, a comparison of past portfolio performance in relation to bid price, how EHC's economic model worked, the language used in each element of the successful June bid, and how EHC sculpts its bids. In addition to this written material, EHC also gave Shanti an extensive oral presentation, which lasted over two hours, and in which Shanti asked many questions. However, Sumitomo and EHC could not reach a deal on a bid for the next portfolio to be offered in December, 1988. Sumitomo's proposed

interest rate was considerably higher than EHC was willing to consider.

This did not prevent Sumitomo from participating in the bidding for the December portfolio, however. In fact, Sumitomo bid directly on the portfolio, in clear violation of the Agreement with EHC. At trial and in this appeal, Sumitomo has claimed that it only invested in a portfolio that was won by a competitor of EHC. However, this proposition was rejected below, and we reject it also. In submitting its bid, Sumitomo worked through Gerry Sherman, who was a former employee of DPF, a competitor of EHC. Sherman had formed his own one-man company, Oasis, which would work on bids for Xerox PAS portfolios. Sherman had experience from his days at DPF in the economic modelling and bidding process for such portfolios. Sumitomo argues that Oasis won the December bid by carrying out the same functions as EHC would have carried out.

This is not true. To us, and to the district court, it is clear that Oasis was merely a stalking horse for Sumitomo, and that Sumitomo was the direct bidder for the December portfolio. Well before the December bid, Sumitomo documents indicated that it was interested in cutting out the middle-man leasing companies and bidding directly on portfolios. Sumitomo noted that because its cost of funds would be cheaper, it could realize a "huge profit." A Sumitomo "contact report" submitted at the end of November 1988, indicates that Sumitomo officials visited the Xerox plant in Rochester (New York, presumably) to view the equipment that would be bid on in the December portfolio. That report indicates that Sumitomo was being invited to participate directly in the bidding process, and that it was important for this information to be kept confidential, so that "no other party knows the role that STB [Sumitomo] is playing." In a later confidential internal report to other bank officials, Shanti crowed about the financial advantages that a bank would

have in competing directly with leasing companies for portfolios. In that same report, Shanti indicated that the bid would have to be made through "a Shell company to avoid having damage to the relationship with . . . Eden Hannon." In addition, when Sumitomo's home office in Tokyo was considering Shanti's proposal, it inquired where Shanti had gotten its detailed information on how the competition would bid. Shanti replied that he had obtained information from two Xerox officials and from EHC and Sherman. This is not even the whole of it, for in numerous other documents generated by Shanti for Sumitomo, and in Xerox documents, it is made clear that Sumitomo was the bidder and purchaser. For example, in a letter to Sumitomo from Sherman (not on Oasis stationary), Sherman demands a fee of .25% of the deal's value in exchange for his "introducing" the Xerox opportunity to Sumitomo and for "expedit[ing] the successful conclusion of these opportunities." Most importantly, regarding the document announcing Sumitomo's bid to Xerox, although it was typed on Oasis stationary and signed by "Jerry (sic) Sherman", the letter describes the bid as "a proposal for a direct purchase by Sumitomo. . . ." Thus, there is no doubt in our minds that Sherman was a mere stalking horse, and that Sumitomo violated its Agreement with EHC by making this bid.

Unfortunately, it is unclear whether Sherman also provided the financial advice to Sumitomo that enabled it to make its bid. Sherman did work on the Xerox PAS Program when he was employed by EHC's competitor, DPF. Sumitomo has claimed that it gained all of its knowledge on how to value and bid for a Xerox portfolio from Sherman. While Sumitomo admits that it had possession of the confidential materials it got from EHC, it claims that did not use these materials *at all.* It states that after negotiations fell through with EHC on August 25, 1988, Shanti put these materials in a box and never looked at them again. In a close call, the district judge found that

Sumitomo had not misappropriated EHC's trade secrets, and thus, the district judge must have found Sumitomo's story more credible on this point.

Since our disposition of this case does not depend on knowing whether Sumitomo actually used this information, we will not dwell on the point. However, we have our doubts about the correctness of this finding. Recall that when the Tokyo Office asked Shanti where he was getting his detailed information on the competition, Shanti listed one source as "Eden Hannon." This report was dated December 2, 1988, three months after Shanti supposedly put EHC's materials "back in their box." Also, are we supposed to believe that Shanti forgot everything that he previously read in EHC's materials, and forgot all of the additional information he received in EHC's oral presentation? This is doubtful.

II.

We find that the district judge was correct in holding that Sumitomo breached its Noncircumvention and Nondisclosure Agreement with EHC. Sumitomo argued in this appeal, as they did below, that they did not "independently pursue" or obtain an interest in the December portfolio, and that they only invested through another outfit (Oasis) performing the same function as EHC. We agree with the district judge that facts do not support this position, and that it "defies logic and common sense." Oasis was merely a stalking horse for Sumitomo's efforts to avoid its obligations under the Agreement. The district judge correctly granted an injunction to prevent another violation of that Agreement in the future. However, EHC was entitled to additional equitable relief—a constructive trust on Sumitomo's illegally gotten gains. This remedy does not depend on proof of actual damage to EHC; instead, it focuses on the wrongful conduct of the violator. In order to explain why this remedy is

available, it is necessary to explain the role that the Agreement played in the parties' relationship.[2]

The Supreme Court of Virginia has decided several cases involving agreements not to compete in the employment law arena, and those cases are substantially similar to the case at bar. In many employment contracts, there is language stating that upon termination of the employment relationship, the employee is restricted from competing with the employer within a certain amount of time and within a certain geographical area (for the purposes of this opinion, these are called "employment agreements"). The Virginia courts have held repeatedly that employment agreements are enforceable if they pass a three-part reasonableness test:

> (1) Is the restraint, from the standpoint of the employer, reasonable in the sense that it is no greater than is necessary to protect the employer in some legitimate business interest?
>
> (2) From the standpoint of the employee, is the restraint reasonable in the sense that it is not unduly harsh and oppressive in curtailing his legitimate efforts to earn a livelihood?
>
> (3) Is the restraint reasonable from the standpoint of sound public policy?

Paramount Termite Control Co. v. Rector, 238 Va. 171, 380 S.E.2d 922, 924 (1989) (citations omitted). The agreements that pass this test may be enforced in equity.

The Noncircumvention and Nondisclosure Agreement (in the forthcoming discussion, we will call this a "noncircumvention agreement") is nearly identical in purpose to an employment agreement. Most importantly, an employment agreement enables an employer to expose his

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[2] This case is controlled by Virginia law, and we have not found a Virginia case that addresses this type of situation. However, we are not without guidance from Virginia.

employees to the firm's trade secrets. Similarly, a noncircumvention agreement enables potential joint venturers to share confidential information regarding a possible deal. In both instances, the idea is to share trade secrets so that business can be conducted without losing control over the secrets. Often, the value of a firm is its special knowledge, and this knowledge may not be an idea protectible by patent or copyright. If that firm cannot protect that knowledge from immediate dissemination to competitors, it may not be able to reap the benefits from the time and money invested in building that knowledge. If firms are not permitted to construct a reasonable legal mechanism to protect that knowledge, then the incentive to engage in the building of such knowledge will be greatly reduced. Free riders will capture this information at little or no cost and produce a product cheaper than the firm which created the knowledge, because it will not have to carry the costs of creating that knowledge in its pricing. Faced with this free rider problem, this information may not be created, and thus everybody loses. To counteract that problem, an employer can demand that employees sign an employment agreement as a condition of their contract, and thus protect the confidential information. This means that if an employer takes in an employee and exposes that employee to trade secrets, the employer does not have to allow the employee to go across the street and set up shop once that employee has mastered the information. Although it was not explained in this detail, Virginia has recognized this interest in protecting confidential information. *Paramount*, 380 S.E.2d at 925.

These employment agreements (or in the present case, a noncircumvention agreement) are often necessary because it can be very difficult to prove the theft of a trade secret by a former employee. Often, the purpose of an employment agreement can be to prevent the dissemination of trade secrets, yet a mere ban on using trade secrets after the termination of employment would be

difficult to enforce. Judge Lord explained the problem well in *Greenberg v. Croyden Plastics Co.*, 378 F. Supp. 806, 814 (E.D. Pa. 1974):

> Plaintiffs in trade secret cases, who must prove by a fair preponderance of the evidence disclosure to third parties and use of the trade secret by the third parties, are confronted with an extraordinarliy difficult task. Misappropriation and misuse can rarely be proved by convincing direct evidence. In most cases plaintiffs must construct a web of perhaps ambiguous circumstantial evidence from which the trier of fact may draw inferences which convince him that it is more probable than not that what the plaintiffs allege happened did in fact take place. Against this often delicate construct of circumstantial evidence there frequently must be balanced defendants' witnesses who directly deny everything.

Actually, Judge Lord's description of the problem covers just the tip of the iceberg. There are several problems with trying to prevent former employees from illegally using the former employer's trade secrets, and these problems are caused by the status of the law regarding the misappropriation of trade secrets. First, as Judge Lord depicted so well, it is difficult to prove that the trade secret was actually used. Second, the former employee tends to get "one free bite" at the trade secret. Most courts will refuse to enjoin the disclosure or use of a trade secret until its illegal use is imminent or until it has already occurred. By that time, much of the damage may be done. Third, even if a clearly illegal use of the trade secret by a former employee can be shown, most courts will not enjoin that person from working for the competition on that basis. Instead, they will merely enjoin future disclosure of the trade secret. Yet, policing the former employee's compliance with that injunction will be difficult. Finally, even if the employee does not maliciously attempt to use his former employer's trade

secrets in the new employer's workplace, avoiding this use can be difficult. It would be difficult for the employee to guard the trade secret of the former employer and be effective for the new employer. M. J. Hutter, *Drafting Enforceable Employee Non-Competition Agreements To Protect Confidential Business Information: A Lawyer's Practical Approach To The Case Law*, 45 Albany L. Rev. 311, 314-16 (1981). *See also* Milgram, *Trade Secrets* § 7.07[1][a], at 7-184 (1989).

In order to avoid these problems, many employers ask their employees to sign non-competition agreements. These agreements prevent an employee from working with the competition within a limited geographical range of the former employer and for a limited time. As seen above, Virginia courts will only enforce these agreements if they are reasonable. Yet, when they are valid, they make the guarding of a trade secret easier since they remove the opportunity for the former employee to pass on the trade secret to the competition, either malevolently or benevolently. This does not supplant the need for law protecting trade secrets. Non-competition agreements cannot prevent disclosure anywhere in the world and until the end of time, for they would be held unreasonable. Instead, a non-competition agreement will merely prevent the illegal use of a trade secret next door in the near future, where the use might do the most damage.

EHC's position regarding potential investors was the same as an employer-employee relationship in regard to the use of trade secrets. The thing that made EHC valuable was its expertise in valuing lease portfolios. EHC would "sell" its knowledge of the value of a particular PAS portfolio to investors for a percentage of the profit. It was necessary for EHC to share its confidential economic models and projections on the particular bid in order to attract investors. Yet, if it gave this information to an investor without restriction, that investor would merely make the bid directly and cut EHC out of

the deal, after EHC's investment in expertise and research made the bid possible.

EHC could have merely prohibited its potential customers from using its information if that customer became a rival bidder. Indeed, this was the essence of Shanti's counterproposal regarding the language of the agreement, which was rejected by EHC. Such an arrangement would have become an unenforceable honor system. In the present case, Sumitomo has denied that it used the materials it received from EHC, and claimed that it gained its expertise primarily from Gerry Sherman. The trial judge ultimately ruled that there had not been a misappropriation of trade secrets, but his ruling was based on Sumitomo's denials and the citing of Sherman's experience in the area. The trial court did not definitively discover whether Sumitomo actually used these materials, and there was no way that it could have found out. For that reason, EHC chose to include in its agreement with potential investors the noncircumvention clause. Armed with that agreement, EHC could protect its information by merely showing that an investor was competing contrary to the agreement, without having to prove that it was actually using EHC's confidential information.

Virginia courts have also recognized that firms have a legitimate interest in protecting their customer contacts. *Paramount*, 380 S.E.2d at 925. In *Paramount*, the court found that a termite extermination company could legitimately restrict its employees from going to work for a rival company in any county of Virginia where employees had worked, for two years after the termination of their employment. The court found that these restrictions are permissible when they reasonably take into account the need of the employee to make a living, and if they do not impair the competitive nature of the industry in question. *Id.* In so ruling, the Virginia court implicitly recognized the investment that a firm has in its

customer lists. It can require a great deal of time and personal contact to build a solid base of clients. If your sales representatives are free to leave the firm and try to take these clients along at any minute, this investment can be undermined and thus discouraged. An employment agreement that restricts this activity for a reasonable geographical reach can protect this investment while not harming competition in an industry with many competitors.

EHC had such legitimate interests in this case. One reason why it had a noncircumvention clause was to prevent its disclosures from creating new competitors. The competition for the PAS portfolios was already keen. Xerox invited a limited number of businesses to bid for the portfolios, and there were many other businesses who wanted a chance to bid that were seeking invitations. EHC had a legitimate fear that it would let a new bidder through the door if it educated that investor and gave it contacts to Xerox. Thus a reasonable noncircumvention clause was constructed to place a reasonable limit on competition from a temporary ally.

Thus, EHC's noncircumvention agreement is merely a twist on employment noncompetition agreements that have been recognized by the Virginia courts. That being so, we will briefly discuss the application of Virginia's three-factor test for reasonableness to the case at bar. We have reworked the terms of the test so that it will address noncircumvention agreements.

1. Is the restraint on circumvention no broader than is necessary, from the standpoint of the trade secret holder, to protect the holder from the disclosure of its confidential information? Yes. The limitation provided by the noncircumvention clause did not prevent Sumitomo from doing many things. Sumitomo could still invest in a bid won by a competitor of EHC; it could use this information internally in order to put together its own bid for lease portfolios offered by companies other than Xerox;

and Sumitomo could bid directly for PAS portfolios in approximately three or four years after the Agreement was signed. This was a narrowly drawn limitation.

2. From the standpoint of the party that received the confidential information, is the restraint reasonable in the sense that it was not unduly harsh and oppressive in curtailing the legitimate efforts of that party to conduct its business? Yes. Most importantly, Sumitomo could still invest immediately in any winning bids, including EHC's competitors. Also, Sumitomo could bid directly on any other lease program other than Xerox's, and it could directly invest in Xerox's PAS Program after several years. Furthermore, presumably Sumitomo can make (and has made) money in its other banking activities.

3. Is the restraint reasonable from the standpoint of sound public policy? Yes. This factor overlaps the area covered by the first two factors to a great extent. Presumably, public policy seeks to protect the development of trade secrets without ruining competition or driving the receiver of confidential information out of business. As discussed above, this noncircumvention agreement satisfies those concerns. EHC's economic modeling process receives some protection, the bidding for Xerox PAS portfolios remains highly competitive, and Sumitomo will certainly remain a profitable bank.

III.

Now we turn to the appropriate remedy. Equitable remedies are available in Virginia to address the harm visited by a violation of noncompetition agreements. For example, Virginia courts have permitted the use of injunctions to prevent the violation of noncompetition agreements. *See Paramount, supra*; *Roanoke Engineering Sales Co. v. Rosenbaum*, 233 Va. 548, 290 S.E.2d 882 (1982). The Virginia courts have also adopted a policy of great flexibility in fashioning appropriate equitable

remedies to address the violation of noncompetition agreements:

> In the administration of remedies, an equity court is not bound by the strict rules of the common law, but adapts its relief and molds its decrees to satisfy the requirement of the case. Its purpose is the accomplishment of justice, and it will administer such relief as the exigencies of the case demand. The absence of precedents, or novelty in incident, presents no obstacle to the exercise of jurisdiction.
>
> "Equitable remedies . . . are distinguished by their flexibility, their unlimited variety, their adaptability to circumstances, and the natural rules which govern their use. There is in fact no limit to their variety and application; the court of equity has the power of devising its remedy and shaping it so as to fit the changing circumstances of every case and the complex relations of all the parties."

Roanoke Engineering, 290 S.E.2d at 886 (citations omitted), *quoting First Nat'l Bank v. Hughson*, 194 Va. 736, 753-54, 74 S.E.2d 797, 809 (1953) (Buchanan, J., concurring).

Virginia courts will often turn to equitable remedies when money damages are speculative, and this is one of those instances. In addition, an equitable remedy does not preclude a monetary award. *See* 7A M.J., *Equity*, § 10 (1985, 1989 Supp.) A constructive trust (which can also be called an accounting in this instance) is appropriate in the case at bar. It is very difficult to prove the actual damage caused by the theft of a trade secret. *See Greenberg*, 378 F. Supp. at 806, and authorities cited therein. In that case, a constructive trust will serve a two-fold remedial interest; it will force the transgressor to forfeit the illegally-gotten gains, and provide compensation for the plaintiff's injury. *Id.* For example, in *Greenberg*, the court ordered an accounting of the profits

earned by the former employee. It was uncertain how much of the sales of the flavored mouthpiece by the former employee's new company had hurt the sales of the former company. It was far easier to determine the amount of profit earned by the party that misappropriated the trade secret. *Id.*

A similar problem arises in the case at bar. It is difficult to determine the extent of EHC's loss, and far easier to determine the extent of Sumitomo's benefit from the breach of the Agreement. For example, we do not know if EHC would have won the bidding for the December portfolio had Sumitomo not submitted a bid. The record establishes that EHC's bid was ranked third by Xerox officials, behind Sumitomo's and one other. Although the record does not supply much detail on the issue, it does indicate that Xerox did not always award the contract to the highest ranked bidder. Furthermore, given EHC's success in bidding for past portfolios, its chances of succeeding may have been quite good; it is impossible to say definitively. It should be far easier to determine Sumitomo's profits from the breach of the noncircumvention agreement.

IV.

Sumitomo has also appealed the dismissal of its antitrust claims. This issue does not give us great pause. Sumitomo claimed that this suit was brought solely for the purpose of harassing Sumitomo, and by harassing competitors, to monopolize the market for PAS portfolio purchases. As an aside, we doubt that this is the relevant product market definition, since there must be a high cross elasticity of demand between the Xerox PAS portfolio and other lease purchase portfolios. Regardless, Sumitomo loses. Under the *Noerr-Pennington* doctrine,[3]

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[3] *United Mine Workers v. Pennington*, 381 U.S. 657 (1965); *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961).

the filing of a lawsuit (or the seeking of other government action) can only violate antitrust laws when it is a "sham." Since EHC has succeeded in its breach of contract claim and won a constructive trust and an injunction, this suit is hardly a sham. Sumitomo then argues that regardless of merit, a suit can be a sham if it was brought for the *purpose* of being a sham. This cannot be so. It a litigant can persuade a neutral judge or jury that it is entitled to legal relief from the conduct of another based upon the law and facts, that suit cannot be a sham under the *Noerr-Pennington* doctrine. Intent only becomes relevant once the invalidity of the legal claims is established. *See Hospital Building Co. v. Trustees of Rex Hospital*, 791 F.2d 288, 292-93 (4th Cir. 1986) (addresses the role of intent in sham litigation).

V.

Accordingly, we affirm in part, reverse in part, and remand this case for further treatment. None of the rulings as to any of the counts needs to be reconsidered. However, EHC is entitled to a constructive trust over Sumitomo's profits from the purchase of the December 1988 Xerox PAS portfolio. Thus, the district court should determine the amount of Sumitomo's profits on that portfolio, and enter an order awarding that amount to EHC.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED

IN THE UNITED STATES DISTRICT
FOR THE EASTERN DISTRICT OF VIRGINIA
ALEXANDRIA DIVISION

Civil Action No. 89-0312-A

EDEN HANNON & COMPANY,
Plaintiff,

v.

SUMITOMO TRUST & BANKING CO. (U.S.A.),
Defendant.

[PARTIAL TRANSCRIPT DATED
SEPTEMBER 13, 1989]

* * * *

[512] THE COURT: All you have to do though is make it again at the end of the case.

MR. ALBRIGHT: That's true. But the technical aspect, nevertheless, is apt and I think controlling here. And for that reason we take the position that the motion for a directed verdict was waived by the defendant.

THE COURT: All right. I don't find that to be correct. I think that obviously if you were in Virginia state court, that would be true, but I don't believe that's what Rule 50 calls for. And I think a motion for a directed verdict can properly be made because it is being made at the end of the plaintiff's case as the rule would so indicate.

MR. VANDERSTAR: In this case, Your Honor, I will go ahead with a brief motion. And I don't intend to review the evidence on the computer model or the copying or alleged copying or the bidding strategy or anything of that nature. I think the plaintiff, if they can survive a

motion for a [513] directed verdict, I think they will not survive one at the end of the case and will not succeed before the jury in any event, but I think that's a bit complex to deal with at this time. And I want to get on with out case if we are going to have to put one on.

And the reason I say that is that I think there is one hole in the plaintiff's case that is so large that it can easily be recognized and dealt with. So, I have two points I want to make, but one of them may dispose of the entire case and I may not need to make the second one.

It is not enough for a plaintiff to show that the defendant has committed a breach of some duty arising out of contract or tort. So, assuming for the sake of argument that the plaintiff has shown that, we have to go to the next question, has the plaintiff shown injury. Or, sometimes people say, has the plaintiff proved damages. I think a better way to phrase it is has the plaintiff proved injury, because the amount of damages is a separate question.

The plaintiff and Oasis, they claim it is Oasis as a stand-in for Sumitomo, put in bids for this contract. Three other companies also put in bids. Most of the testimony thus far has focused on the interest rate. And there is in evidence the handwritten notes of Mr. Armstrong and his acknowledgment that those are his notes of what the man at Xerox who makes these decisions told him were the interest rates on the five [514] bids that were submitted. The lowest one, it is like golf, the low score wins, was the Oasis bid. The highest, the worst, the fifth out of five was that of the plaintiff.

It leads one to ask the question, what if the Oasis bid had been disqualified for some reason. That happens in government contract cases all the time. The best bid is disqualified. Well, the normal rule is that you then go to the next bidder, you go to the fellow who is number two.

Now, the plaintiff has put in some evidence that this is not a mechanical task, that Xerox exercises discretion, that it makes judgments and so forth and so on. But no

one has suggested, Your Honor, that Xerox is in the habit of making foolish decisions. And in fact, the success of that company going back over the last several decades would indicate that that is not their corporate strategy.

So, I think the only permissible inference from the evidence that is now before the Court is that if the Oasis bid were disqualified, if the Court or the jury were to rule that that was a breach of contract and we ought to look at the scenario that would have taken place if that bid had never been submitted, then we would have to find out who was second. And it is quite clear that that was not Eden Hannon.

I do not see how a plaintiff can come into court and claim damages or injury if it cannot establish that but for the defendant's conduct the plaintiff would have been in a better [515] position.

Now, there was some talk about level playing fields and in my opinion and so forth and so on. Some of that evidence was not allowed, as it shouldn't have been, because the cold fact is that Eden Hannon would not have won that bid if Oasis had not bid. And, therefore, they cannot show injury. And, therefore, the case should come to an end.

Now, I also want to address the punitive damages count, but perhaps I should take that separately after—

THE COURT: All right, let's deal with this.

MR. VANDERSTAR: Thank you.

MR. ALBRIGHT: Your Honor, I don't think that I have to tell the Court that a motion for a directed verdict should be viewed from the standpoint of all evidence being viewed most favorably to the plaintiff and all reasonable inferences drawn from that evidence to be drawn in favor of the plaintiff.

There are, on the contract count, clearly this has been established, one, that the contract exists.

Two, that the contract establishes that there was a need to disclose confidential information to the defendant.

Three, the facts establish that confidential, sensitive and trade secret information was given to the defendant for the defendant's consideration of a loan.

Fourth, that we demanded that information back, and we have not received it. That is breach number one.

* * * *

[516] Number two, that the information conveyed to the defendant should not be misused or misappropriated. And we have established breach number two. We have showed that they have used it and they have copied it, at least in four instances according to Dr. Vandaele.

Next we have established, I think without peradventure of doubt, that the defendant has obtained in confidence our bidding strategy, has obtained in confidence our commercial, commercially sensitive information, which is trade secrets within the definition of the statute. And that this provided a competitive advantage to the defendant and was used by the defendant, as we have established through the exhibit where Tokyo sent a question to New York saying, how did you intercept these prices and should we bid lower. And Mr. Shanti said he got them from talking with Eden Hannon. He didn't get Eden Hannon's information from anybody else because the evidence in our case establishes nobody else told him about Eden Hannon's bid, bidding strategy or probable bid other than Eden Hannon.

Fifth, we have—That is breach number three. Breach number four of the agreement is that paragraph six is a noncircumvention paragraph. We have testimony from Mr. Armstrong that that word has trade usage meaning. And it means that you don't go around somebody to compete and buy that portfolio directly.

Looking at the evidence most favorably to the [517] plaintiff, the concocted bid by Mr. Sherman on December 6, 1988, is no more than that. It is a bid by Sumitomo. If you read, as I am sure the Court has or will, the bid letter itself, it says that he is pleased to submit on behalf of Sumitomo a bid. That bid won. This was

not anything other than a sham and a shell game in order to try and get around paragraph six restrictions.

And I think our evidence shows very clearly that Sumitomo had in mind doing just that. Mr. Shanti's call report of October 28 says, don't talk about what we are going to do in September in buying directly because nobody knows the role that Sumitomo is playing. So, they circumvented it and they breached it.

Let's assume that Mr. Vanderstar is absolutely right and let's assume that there is, there is zero dollars in damages that we proved. Let's assume the worst case scenario. We have established a breach and we are entitled to, at the minimum, nominal damages for a breach. It can go to the jury just for nominal damages alone.

Have we established more than nominal damages? We have. We have established, I think to a preponderance of the evidence, again viewing all the evidence most favorably to us, that our bid and Sumitomo's bid were extremely close. Mr. Vanderstar asked some witnesses about Eden Hannon having ranked third. And the witnesses said, even if you assume that we [518] ranked third and you knock out Sumitomo, you have Mr. Cutri's testimony that, and I think you remarked on that before, that he has awarded the portfolios to other than the number one ranked bidder before.

And I want to go on and illustrate other factors which have been less than Mr. Vanderstar would have the Court to believe important to Xerox, interest being one. Mr. Cutri said interest was not that big of a deal in December in the testimony that I read in.

So, I think that if you consider that along with some very other important information, that information being not only did Cutri say he has given the contract to other than number one before, and that interest was not that important, and you take into consideration Eden Hannon's success rate in the past and how well they have done, I don't think that there is any question but there is sufficient evidence for a jury to conclude, based on

drawing reasonable inferences from the evidence, that Eden Hannon would have won. It was more probable than not that they would have won.

Even though you disagree with that, I don't think—Even though you may not conclude that if you were sitting without a jury, I think there is sufficient evidence in the record from which that conclusion could be drawn.

Yes, there is no question but that I can't prove it to a mathematical certainty. I have admitted that in the [519] beginning of the case and I admit it now. But I can, I think with my evidence, tip the scales just enough to satisfy the preponderance of the evidence standard on count one.

We have established in count one on the breach of contract that we had bidding costs, that we incurred bidding costs. We have established that the model, which we conveyed to them, cost approximately $150,000. That is the value of it to Eden Hannon. I believe that there is sufficient evidence from which damages can be inferred and awarded on count one.

I am prepared to speak further if you have any further questions, but I think that, again, viewing the evidence most favorable to the plaintiff and drawing all the reasonable inferences that can be drawn in favor of the plaintiff, that we certainly have proved damages for breach of contract.

And even if we haven't proved a nickel in damages, the law does not say no harm no foul. It may say you are not going to get more than a dollar, but at least we have proved a breach. I don't think there is any dispute about that. The simple breach is we have asked for the stuff back and they have never given it to us.

THE COURT: All right.

MR. ALBRIGHT: So, that's on count one. And I guess you want to treat these in seriatim?

THE COURT: It seems to me that this question of damage, the only issue that he really raised and argued was the [520] question of damage. And I think you have

argued that. And I think the question of damage goes to all three counts. And, frankly, that's the issue that concerns me in this case. And it goes back to the ruling that I got involved in in connection with this expert this morning and spent a fair amount of time with.

And I would find from the evidence and giving the plaintiff all the reasonable inferences that can be given to this evidence, that there has been no showing of damage to this, or monetary damage to this plaintiff.

Now, there was testimony by Mr. Cutri as to how these bids were done, and what the criteria was that he used, and the fact that he didn't always take the highest interest rate as you indicated. But we have a situation in this case where there were five bidders. And I find that the burden would be on the plaintiff, if they are going to allege damage as a result of losing this particular bid, would have to show that they would have received the bid had it not been for this other company's acts, Sumitomo's acts.

And the same thing is true with the bidding costs. While there is some showing of the bidding costs, there is no showing here that they lost bidding costs for any reason of the defendant. They could have lost them because any one of the four other people or any one of the other three would have been awarded this contract. And that just simply isn't sufficient [521] to prove a case of money damages.

Now, what that means, I find, is that as far as count one and the breach of contract is concerned, that that count shall go forward as far as any equitable claims may be left in the enforcement of this contract or any provisions of the contract. The plaintiff has shown a prima facie case that a contract exists and that in fact there were breaches that would be entitled to go forward on the equitable claims to be redressed.

As far as the misappropriation of trade secrets is concerned, while there hasn't been a sufficient showing of damages in this case in regard to this particular bid, as

I have just indicated, there has been sufficient evidence put on to go forward that this defendant did take and use certain trade secrets. And whatever equitable remedies may be available as far as unjust enrichment shall go forward.

As far as count three is concerned, that alleges a tort of breach of fiduciary duty. That count, an element of that count requires a proof of damage. And again, that rests on the losing of this bid, which I have already addressed. And I would find that the elements of that count have not been met, and that count three would be dismissed.

Which the purport of this ruling would be that there is nothing here in the complaint for the jury to determine as far as money damages are concerned, but this case would go [522] forward on the breach of contract and misappropriation of trade secret counts as to any equitable relief that the plaintiff may be entitled to.

Now—

MR. ALBRIGHT: Your Honor, if the Court would please allow one point to be made. Will you entertain a comment? I believe the law on count three is that on the breach of fiduciary duty, one can obtain as an award unjust enrichment. If trust and confidence is broken, then I believe in that—

THE COURT: Well, did you ask for that in that count?

MR. ALBRIGHT: We did. I am—

MR. DARVILLE: Expressly.

THE COURT: Then I will modify my ruling to the extent that count three will go forward as to any equitable relief that the plaintiff might be entitled to. I apologize. In reading through that complaint I thought that the unjust enrichment simply went to count two.

MR. ALBRIGHT. Now, if the Court please, on the misappropriation of trade secrets, I believe that I should be able to, I should be entitled to prove and I think I have proved and I think I can argue to a jury the value

of the secrets taken and what amount of money there is to compensate us for the value of the information taken. The Court has ruled that there is evidence that trade secrets were misappropriated. And I believe that is subject to a monetary damage award.

[523] THE COURT: Well, I think I ruled on that. And if I haven't in sufficient particularity, I will. That issue was raised early this morning. And I listened carefully to the testimony of the expert that was to be put on. And I heard no evidence presented of the value of any particular information that they may have received as a monetary loss to the plaintiff.

MR. ALBRIGHT: That's correct, Your Honor.

THE COURT: The only evidence in this case is that it costs so much in terms of time to develop. And my ruling would be that simply isn't sufficient to go forward on a claim for monetary loss.

MR. ALBRIGHT: Very well, Your Honor. And the argument that I made earlier this morning in regard to the analysis that I would proffer in chambers on the measure, how I could measure that through the value gained by the defendant in this case, is being rejected by the Court?

THE COURT: Yes. Now, I have some questions about the defendant's counterclaims.

MR. VANDERSTAR: About what, sir?

THE COURT: About your counterclaim.

MR. ALBRIGHT: I was just going to move on that.

MR. VANDERSTAR: May I raise a point though just to clear the air on something? We have made it perfectly clear to the plaintiff that when this case is over, they can have their due diligence binder and all of the copies back.

* * * *

IN THE UNITED STATES DISTRICT
FOR THE EASTERN DISTRICT OF VIRGINIA
ALEXANDRIA DIVISION

Civil Action No. 89-0312-A

EDEN HANNON & COMPANY,
Plaintiff,

v.

SUMITOMO TRUST & BANKING CO. (U.S.A.),
Defendant.

[PARTIAL TRANSCRIPT DATED
SEPTEMBER 14, 1989]

* * * *

[704] MR. ALBRIGHT: Don't forget, Your Honor, the presentation of the case in the plaintiff's case was before directed verdict and before the Court has taken the jury away. And Dr. Vandaele testified as to the total profits made by the bank. Mr. Siwek has come in and questioned Dr. Vandaele's calculations and has raised questions about them. I think in this setting it is totally appropriate for the expert to answer the objections made by Mr. Siwek, and to also offer to the Court a calculation that has been presented in evidence as a result of my cross-examination of the defendant's witnesses in their case.

So, it has been raised in the defendant's case.

THE COURT: Objection sustained.

MR. ALBRIGHT: Very well, Your Honor.

THE COURT: Is there anything else?

MR. ALBRIGHT: With that, I will rest.

THE COURT: All right. Do you gentlemen desire to present anything further to me? I am reluctant to enter-

tain much argument after I have listened to the argument on the [705] notions in this case already, and I have listened to rather lengthy arguments on the motion for a directed verdict. And it seems to me we have pretty thoroughly argued every issue that is involved in this case.

I am prepared to rule in the case. If you all did want some time to present some proposed findings and conclusions of law to me on these two issues and separate them out as the two issues remaining, I will be glad for you to do it. If you want me to rule, I will rule now.

MR. VANDERSTAR: Well, Your Honor, I rise only because of course we did have extensive argument on aspects of the directed verdict motion, but we have now put in our case. And we have put in what I believe is overwhelming evidence that there was no copying on either the bidding strategy or on the details of this computer print—

THE COURT: I understand. It seems to me though that I have heard some argument from you as to what you were going to put on. And you argued that pretty well at the time that you told me what you were going to do.

MR. VANDERSTAR: Well then I can perhaps make my argument very brief and say I think I have proved what I said I was going to prove. And we would be prepared to abide by Your Honor's wish as to whether you want us to submit proposed findings or Your Honor would simply prefer to conclude the case at this point.

[706] THE COURT: How about you, Mr. Albright?

MR. ALBRIGHT: I agree with Mr. Vanderstar, we are ready to accept your ruling.

THE COURT: All right. Well, there are two issues still remaining in this case as to whether or not there was a breach of the contract as it relates to this noncompetition clause or the noncircumvention clause that has been referred to several ways, but deals with paragraph six in the contract. And also whether or not there was a mis-

appropriation of trade secrets. And I will deal first with the misappropriation of trade secrets.

I would find after having listening to all the evidence that has been presented here, that there was in fact no misappropriation of trade secrets. I have listened to the gentleman testify here, Mr. Jerry Sherman, who prepared the bid. And I have listened to the other witnesses who have testified on behalf of the defendant bank, who have indicated no use or disclosure of the information that may have been obtained by virtue of the meetings with the plaintiff. That that information was not conveyed to Mr. Sherman, and that it was not used.

And I find that there is no misappropriation of the trade secrets, and would find for the defendant as to that count.

However, as to count one, I do find that there is a [707] breach of the provision in this contract whereby the defendant and/or its affiliates agreed not to independently pursue lease transactions with the Xerox Corporation.

Now, while the argument has been made that dealing with an intermediary doesn't, it doesn't really matter whether you take title in your own name or whether you have it in the name of an intermediary or you use some straw company or whatever you do, but that to me just defies logic and common sense and I think defies the law. When you buy something from somebody and take title in your own name, you have entered into a transaction and you have purchased equipment.

And I think the evidence is clear that the defendant bank did in fact buy this equipment in its own name and entered into this transaction with Xerox which it agreed not to do.

And for those reasons I believe that the plaintiff is entitled to an injunction that that conduct will not happen again during the period of this lease.

And I will reserve the right to amplify the findings and conclusions that I have made here from the bench in the event that this case would go any further.

I will go about drafting the specific language—Well, let me just put it this way. If counsel desires to have some input on the wording of my injunctive order that I enter, I would be happy for you all to do so.

If you would rather I would just simply issue an order, [708] I will go ahead and do that as well.

MR. ALBRIGHT: What about unjust enrichment, Your Honor, and breach of fiduciary duty?

THE COURT: Well, breach of fiduciary duty I dismissed at the original motion. The unjust enrichment theories only go with the misappropriation of the trade secrets, as I view this case, and I would not award any damages. By virtue of breach of contract I do feel that you are entitled to injunctive relief to see that that doesn't happen again.

As I have already ruled, you have failed to prove any damage as a result of this original breach to go forward with. I think you are entitled to the relief to see that this does not happen again, but nothing beyond that.

MR. ALBRIGHT: Thank you, Your Honor.

MR. VANDERSTAR: Did you mean to address His Honor's request about the form of injunctive relief, Ralph?

MR. ALBRIGHT: I think we should probably draft that for you.

THE COURT: Why don't you all get together and present an order to me if you desire to do that, there may be something in particular that you want in it, and I will take a look at it once it is presented.

MR. ALBRIGHT: Yes, sir.

MR. VANDERSTAR: We will do that, Your Honor.

THE COURT: Thank you, gentlemen. And if we have no [709] further business, we will adjourn until tomorrow morning at 9 o'clock.

PARTIAL TRANSCRIPT CONCLUDED

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
ALEXANDRIA DIVISION

Civil Action No. 89-0312-A

EDEN HANNON & COMPANY,
Plaintiff,

v.

SUMITOMO TRUST & BANKING CO. (U.S.A.),
Defendant.

INJUNCTION

This matter having come before the Court for trial on the merits, the Court having directed the verdict against the plaintiff on its damage claims, and against the defendant on its counterclaims, announced its findings of fact and conclusions of law in open court on September 14, 1989, which are incorporated herein, and the Court having found that plaintiff and defendant entered into a Nondisclosure and Noncircumvention Agreement dated July 14, 1988 (PX 5) ("Agreement"), paragraph 6 of which provides that the defendant will not compete with the plaintiff on any quarterly Xerox Partnership Asset Strategy Program ("Xerox PAS") portfolio for a period of five (5) years from June 24, 1988, or until June 23, 1993, and the Court having further found that the defendant breached the Agreement by competing for and acquiring the December 1988, quarterly Xerox PAS portfolio, it is hereby:

ORDERED that judgment be and the same hereby is entered in favor of the plaintiff against the defendant on Count I of the complaint, together with costs, and it is further,

ORDERED that the defendant, Sumitomo Trust & Banking Co. (U.S.A.) ("Defendant") and its affiliates, representatives, subsidiaries, parent company, agents, and others acting in concert with defendant, shall be and they hereby are permanently ENJOINED from competing with plaintiff for, purchasing, acquiring title in, acting as original lessor in, or originating the purchase of, any quarterly portfolio offered for sale by Xerox Corporation in its Partnership Asset Strategy Program, for a period of five (5) years from June 24, 1988, or up to and including June 23, 1993.

/s/ Claude M. Hilton
United States District Judge

Alexandria, Virginia
September 25, 1989

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Filed November 6, 1990

No. 89-2201

EDEN HANNON & COMPANY,
Plaintiff-Appellant

v.

SUMITOMO TRUST & BANKING COMPANY,
Defendant-Appellee

No. 89-2208

EDEN HANNON & COMPANY,
Plaintiff-Appellee

v.

SUMITOTO TRUST & BANKING COMPANY,
Defendant-Appellant

ON PETITION FOR REHEARING WITH
SUGGESTION FOR REHEARING IN BANC

The appellee's petition for rehearing and suggestion for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestion for rehearing in banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

IT IS ORDERED that the petition for rehearing and suggestion for rehearing in banc are denied.

Entered at the direction of Judge Russell with the concurrence of Judge Widener and Judge Hall.

For the Court,

/s/ John M. Greacen
Clerk

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Filed: November 13, 1990

No. 89-2201

EDEN HANNON & COMPANY,
Plaintiff-Appellant,

versus

SUMITOMO TRUST & BANKING COMPANY,
Defendant-Appellee.

ORDER

Appellee/cross-appellant has filed a motion for stay of mandate pending application to the United States Supreme Court for writ of certiorari and appellant/cross-appellee has filed a memorandum in opposition to the motion.

The Court denies the motion for stay of mandate.

For the Court—By Direction

/s/ John M. Greacen
Clerk

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Filed November 13, 1990

No. 89-2201

EDEN HANNON & CO

v.

SUMITOMO TRUST & BAN

No. 89-2208

EDEN HANNON & CO

v.

SUMITOMO TRUST & BAN

MANDATE

The judgment of this court dated 9/19/90 takes effect today.

JOHN M. GREACEN
Clerk